Attachment 3

CalPERS

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August 18, 2008

AGENDA ITEM 9a

TO: MEMBERS OF THE INVESTMENT COMMITTEE

I. SUBJECT: Environmental Manager Annual Review

II. PROGRAM: Global Equity

III. RECOMMENDATION: Renew the contracts of CalPERS' five external environmental equity managers listed below for a period of one year. Wilshire Associates' opinion letter and disclosure letter are shown in Attachments 1 and 2.

Domestic Environmental External Equity Managers
AXA Rosenberg Investment Management
New Amsterdam Partners
State Street Global Advisors

International Developed Markets Environmental External Equity Managers
Brandywine Global Investment Management
State Street Global Advisors

IV. ANALYSIS:

Executive Summary

The performance of the entire environmental external equity manager program for the fiscal year ending June 30, 2008 was -9.58%. This program performance was 1.26% above the benchmark. Current assets in this program are $493.9 million.

Background

At its April 19, 2004 meeting, the Investment Committee considered environmental investing strategies, including environmentally screened public equity funds performing as well or better than their non-screened counterparts. Specifically targeted were stock portfolios in environmentally screened funds managed by leading active public equity investment managers with proven track records. At this meeting the Investment Committee voted to allow staff, in its discretion, to either: (1) hire external managers for up to $500 million total, (2) allocate up to $500 million to mutual funds that have good records, or (3) a combination thereof, to achieve the best results for the System.

Mutual funds were considered first with a Request for Information (RFI) issued in September 2004. On April 1, 2005, CalPERS invested in BGI's iShares KLD Select Social Index Fund, an Exchange Traded Fund (ETF). On May 13, 2005, a Request for Proposal (RFP) was issued to firms identified through the prior RFI search. The RFP was advertised in *Pensions and Investments* and the *Financial Times*.

Five firms and six products were recommended to and approved by the Investment Committed at its November 14, 2005 meeting, creating a pool to which additional products may be added in the future. CalPERS contracted with and funded five products over the period February 1, 2006 to June 1, 2006. After engaging and funding the five products mentioned above, the investment in BGI's iShares KLD Select Social Index Fund was liquidated. The last month of performance for this product was July 2006.

At the April 2007 Investment Committee meeting, the Global Equity delegation for environmental managers was changed from $500 million to a range of 0% - 0.5% of Global Equity, or about $600 million currently.

All of the managers have one year renewable contracts contingent upon the Investment Committee's annual approval. Each contract also contains a provision allowing for termination upon 30 days' notice.

Assets under Management

As of June 30, 2008, total assets under management by the external environmental managers were $493.9 million. Table 1 shows the assets managed by each manager as of this date.

Table 1

Manager	Mandate	Portfolio Value (millions)	Portfolio Percent
Domestic Managers		**$290.5**	**58.8%**
AXA Rosenberg Investment Mgmt.	U.S.	$133.2	27.0%
New Amsterdam Partners	U.S.	$79.2	16.0%
State Street Global Advisors	U.S.	$78.1	15.8%
International Managers		**$203.4**	**41.2%**
Brandywine Global Inv. Mgmt.	Dev ex-U.S.	$78.2	15.8%
State Street Global Advisors	Dev ex-U.S.	$125.2	25.4%
Total External Environmental Equity		**$493.9**	**100.0%**

Source: State Street Bank

Program Performance

The performance objective of all environmental portfolios is to exceed the benchmark returns, net of management fees, over a full market cycle, considered to be three to five years.

Over the 2007/2008 fiscal year, the CalPERS Environmental External Equity portfolio in aggregate outperformed the custom benchmark by 1.26%. All returns in this report are net of management fees and are CFA Institute compliant.

Table 2 illustrates each manager's performance relative to its respective benchmark since the initial funding date.

Table 2

Environmental External Equity Relative Performance	Fiscal* Year 05/06	Fiscal Year 06/07	Fiscal Year 07/08	Annualized Since Inception	IR**	Inception Date
Domestic Managers						
AXA Rosenberg	(0.80)%	(0.84)%	3.79%	1.24%	0.32	4/1/06
New Amsterdam Partners	(2.76)%	(5.37)%	6.14%	(0.25)%	(0.06)	2/1/06
State Street Global Advisors	0.19%	(0.73)%	(0.26)%	(0.34)%	(0.13)	6/1/06
International Managers						
Brandywine	(2.10)%	(0.44)%	(4.67)%	(3.73)%	(1.09)	5/1/06
State Street Global Advisors	1.64%	4.03%	0.90%	2.67%	0.94	3/1/06
Total Environmental	**(1.27)%**	**(0.77)%**	**1.26%**	**(0.21)%**		**2/1/06**

Source: State Street Bank Returns are net of fees and CFA compliant.
*Note FY 05/06 was a partial year beginning February 1, 2006.
**Note the information ratios may not be meaningful as the program does not have 36 months of data.

As noted in Table 2 above, Brandywine, an international manager with a value style, had a particularly difficult year and has struggled over its 26 month history with CalPERS. Staff and Wilshire continue to closely monitor this manager's performance relative to its benchmark and other managers with a similar style bias.

The following two charts illustrate the program profile as of June 30, 2008. Chart 1 plots performance, by six month periods, of the total program and its benchmark, as well as the cumulative active return since inception.

Chart 2 plots the risk/return profile of each of the managers and the total program, using active return and tracking error. The size of the bubbles reflects the proportion of assets in each portfolio as of June 30, 2008.

Chart 1

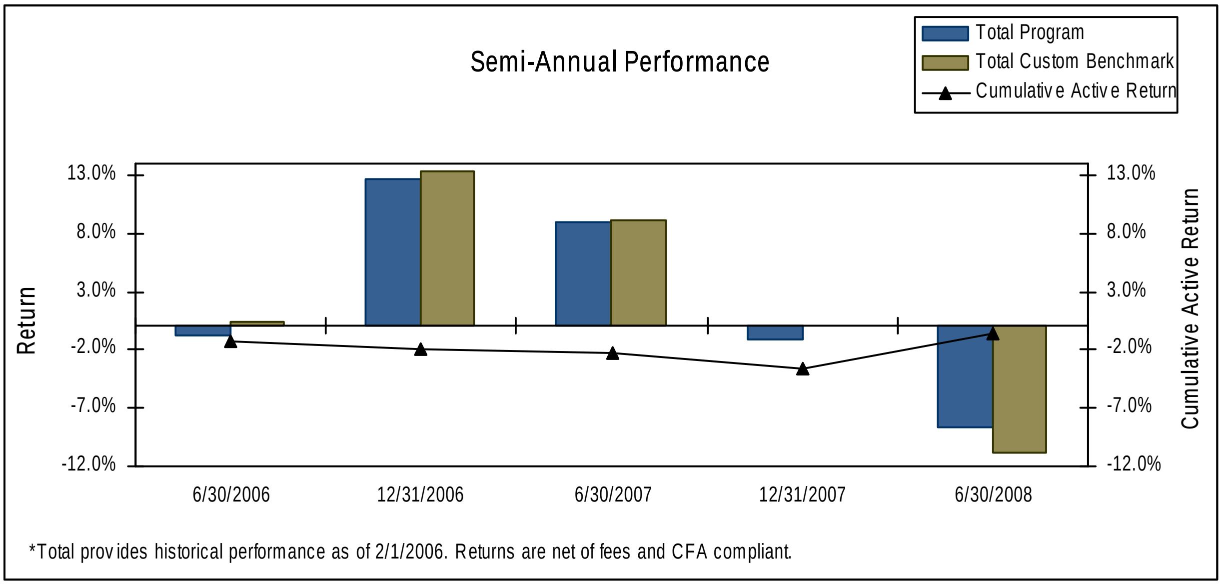
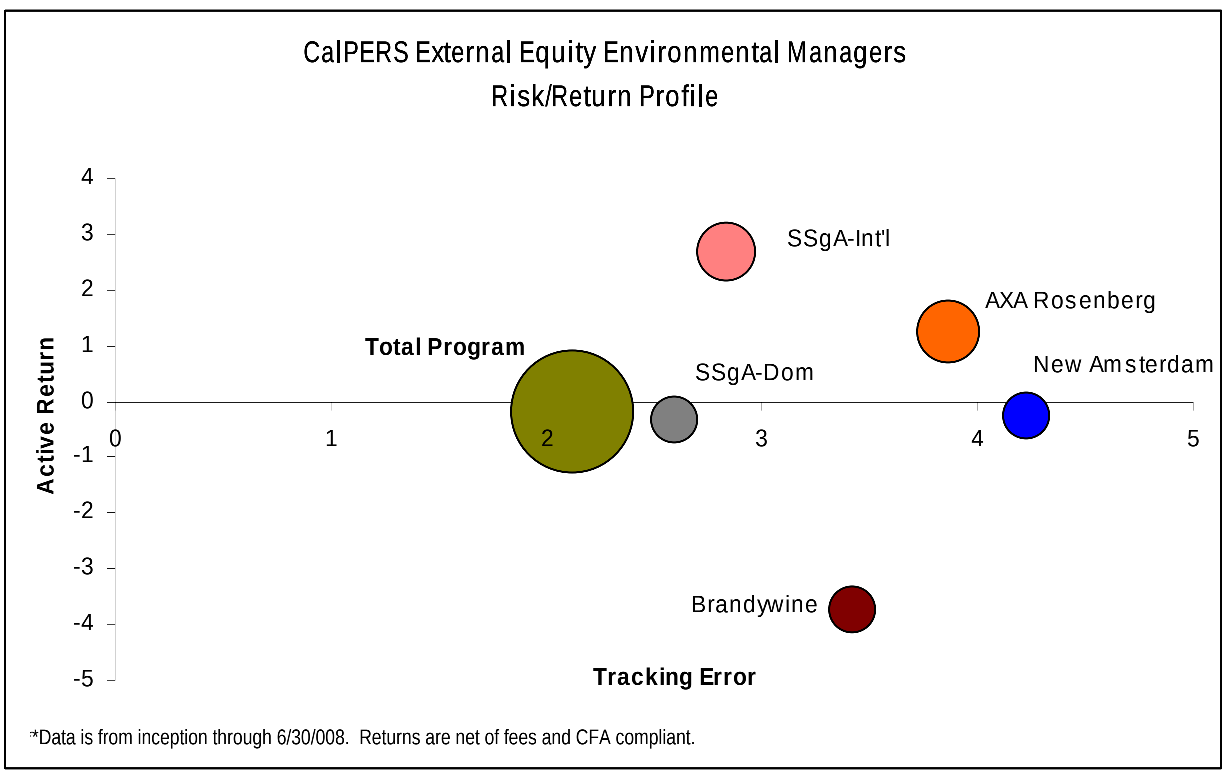


Chart 2



The managers currently in CalPERS' environmental program also run these portfolios using the same or similar processes without the environmental overlay. Table 3 below contrasts the performance of the CalPERS environmental portfolios against the managers' unconstrained composites from the inception of each CalPERS portfolio through June 30, 2008. Because the managers' composite data is gross of fees, in this chart only, CalPERS' environmental manager performance is shown gross of fees.

As can be seen in Table 3, there can be a wide variation in results. Over this time period, two of the five managers' environmental strategy outperformed their unconstrained strategy composite.

Table 3

Manager	CalPERS Environmental Performance	Unconstrained Portfolio Performance	Difference	Inception Date
Axa Rosenberg	2.90%	4.14%	(1.24%)	4/1/06
New Amsterdam	1.99%	(0.17%)	2.16%	2/1/06
SSgA – Domestic	1.88%	5.32%	(3.44%)	6/1/06
Brandywine	2.13%	3.98%	(1.85%)	5/1/06
SSgA - International	11.67%	7.35%	4.32%	3/1/06

*All returns are shown gross of management fees.

Individual Manager's Performance and Evaluation

The following section of the agenda item contains a one page write-up for each manager in the environmental program.

AXA Rosenberg Investment Management (Domestic)

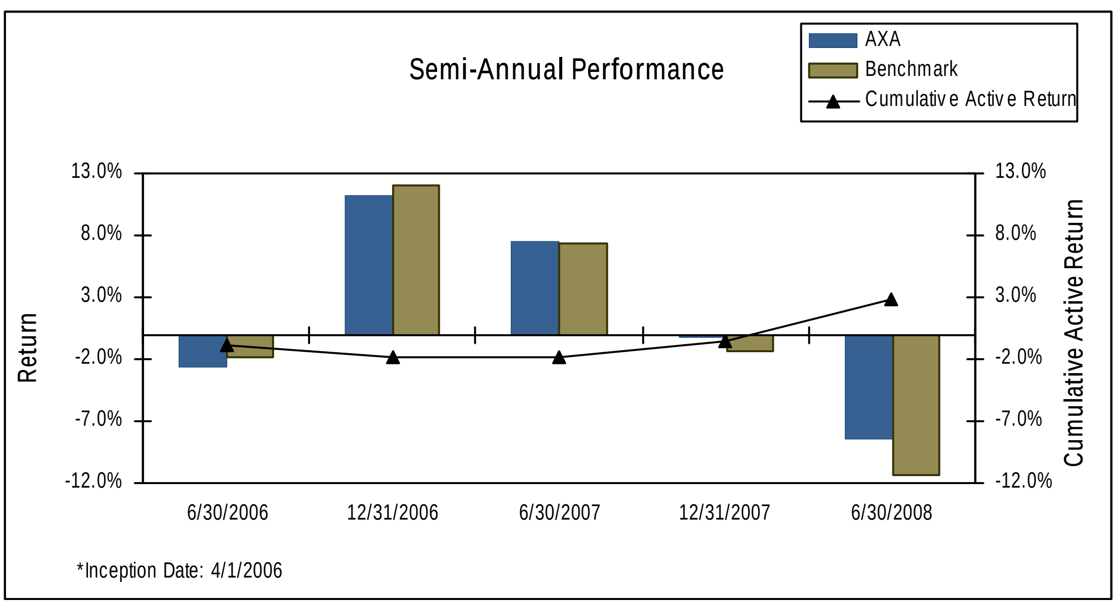
AXA was funded on April 1, 2006. This manager's stock selection process includes two fundamental insights. A valuation model identifies bargains and expensive stocks within each industry. An earnings forecast model identifies companies with superior/inferior year-ahead earnings. AXA receives a list of restricted companies from the Investor Responsibility Research Center (IRRC) based on federal environmental law violations, regulatory problems, and substantial emissions, spills and releases. These stocks are removed from the investment universe. The portfolio typically holds 200-250 stocks.

For the fiscal year ending June 30, 2008, AXA outperformed the benchmark by 3.79%. The excess return was driven by the portfolio's overweight in the energy sector, as well as stock selection within the energy, information technology, and materials sectors. From inception, AXA has outperformed its benchmark by 1.24% on an annualized basis. Assets under management as of June 30, 2008 were $133.2 million.

Manager	Fiscal Year 05/06	Fiscal Year 06/07	Fiscal Year 07/08	Annualized Since Inception*
AXA	(2.57%)	19.54%	- 8.67%	2.79%
Benchmark	(1.77%)	20.38%	-12.46%	1.55%
Active Return	(0.80%)	(0.84%)	3.79%	1.24%

*Inception Date 4/1/06 Source: State Street Bank Returns are net of fees and CFA compliant.

The chart below shows AXA's performance versus its benchmark. The axis on the left measures the manager's semi-annual performance against its benchmark. The right axis measures AXA's cumulative performance relative to the benchmark.



New Amsterdam Partners (Domestic)

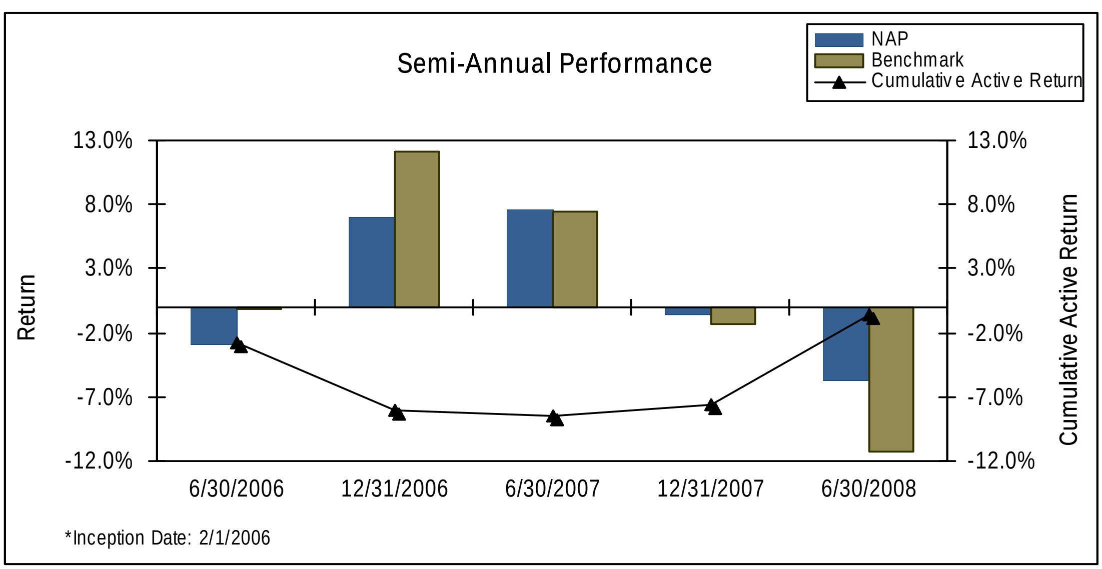
New Amsterdam Partners was funded on February 1, 2006. This manager's blend of quantitative and fundamental research identifies mispriced securities with better than average forecast growth and profitability. Companies' environmental and social responsibility records are examined carefully by the firm's analysts. The objective is to build a portfolio that will outperform the market, while being environmentally and socially responsible. The portfolio typically holds 40-45 stocks.

For the fiscal year ending June 30, 2008, New Amsterdam outperformed the benchmark by 6.14%. New Amsterdam benefited as the market reversed this year in terms of rewarding growth-oriented styles rather than value. This manager's underweighting in financials significantly contributed to its outperformance. Stock selection in the energy, health care, materials, and industrials sectors also contributed. From inception, New Amsterdam has underperformed its benchmark by 25 basis points on an annualized basis. Assets under management as of June 30, 2008 were $79.2 million.

Manager	Fiscal Year 05/06	Fiscal Year 06/07	Fiscal Year 07/08	Annualized Since Inception*
NAP	**(2.99%)**	**15.01%**	**(6.32%)**	**1.85%**
Benchmark	**(0.23%)**	**20.38%**	**(12.46%)**	**2.10%**
Active Return	**(2.76%)**	**(5.37%)**	**6.14%**	**(0.25%)**

*Inception Date 2/1/06   Source: State Street Bank   Returns are net of fees and CFA compliant.

The chart below shows New Amsterdam's performance versus the benchmark. The axis on the left measures the manager's semi-annual performance against its benchmark. The right axis measures New Amsterdam's cumulative performance relative to the benchmark.



State Street Global Advisors (Domestic)

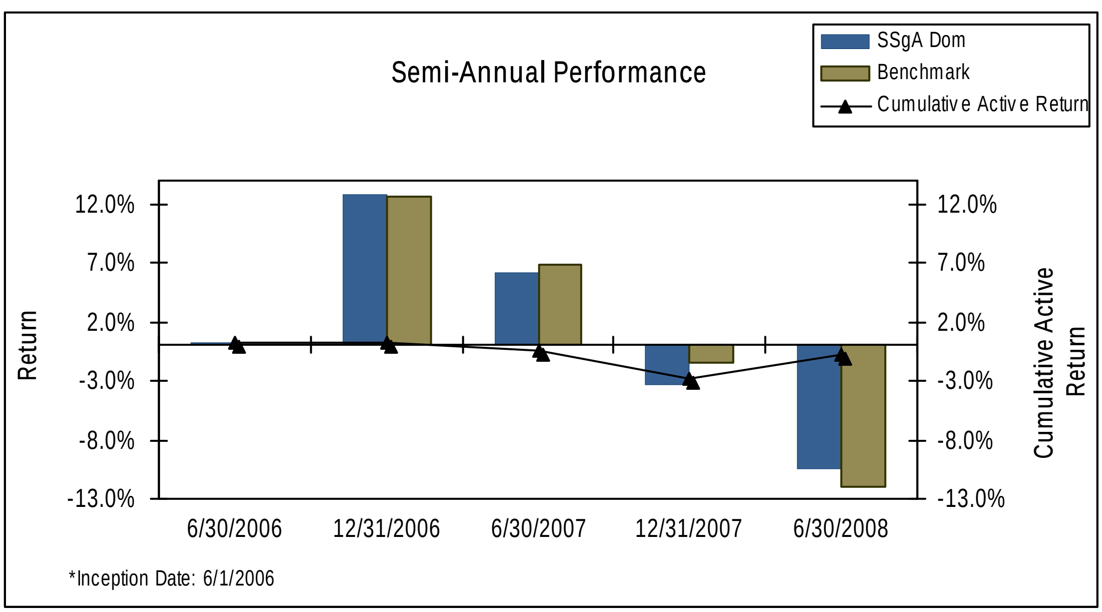
State Street Global Advisors (SSgA) was funded on June 1, 2006. This U.S. Core Environmental Strategy is quantitative, bottom-up, well-diversified, and consists of large cap securities, with reduced exposure to companies with poor eco-efficiency, using ranking provided by Innovest. The strategy is managed to have characteristics similar to the S&P 500 Index. The portfolio typically holds 70-150 stocks.

For the fiscal year ending June 30, 2008, SSgA underperformed the benchmark by 32 basis points. Stock selection in the financials sector contributed positively to this year's relative performance but stock selection within the healthcare and energy sectors detracted from relative performance. From inception, the SSgA domestic portfolio has underperformed its benchmark by 38 basis points on an annualized basis. Assets under management as of June 30, 2008 were $78.1 million.

Manager	Fiscal Year 05/06	Fiscal Year 06/07	Fiscal Year 07/08	Annualized Since Inception*
SSgA-Dom	**0.28%**	**19.66%**	**(13.54%)**	**1.79%**
Benchmark	**0.09%**	**20.39%**	**(13.28%)**	**2.13%**
Active Return	**0.19%**	**(0.73%)**	**(0.26%)**	**(0.34%)**

*Inception Date 6/1/06   Source: State Street Bank   Returns are net of fees and CFA compliant.

The chart below shows SSgA's performance versus its benchmark. The axis on the left measures the manager's semi-annual performance against its benchmark. The right axis measures SSgA's cumulative performance relative to the benchmark.



Brandywine Global Investment Management (International)

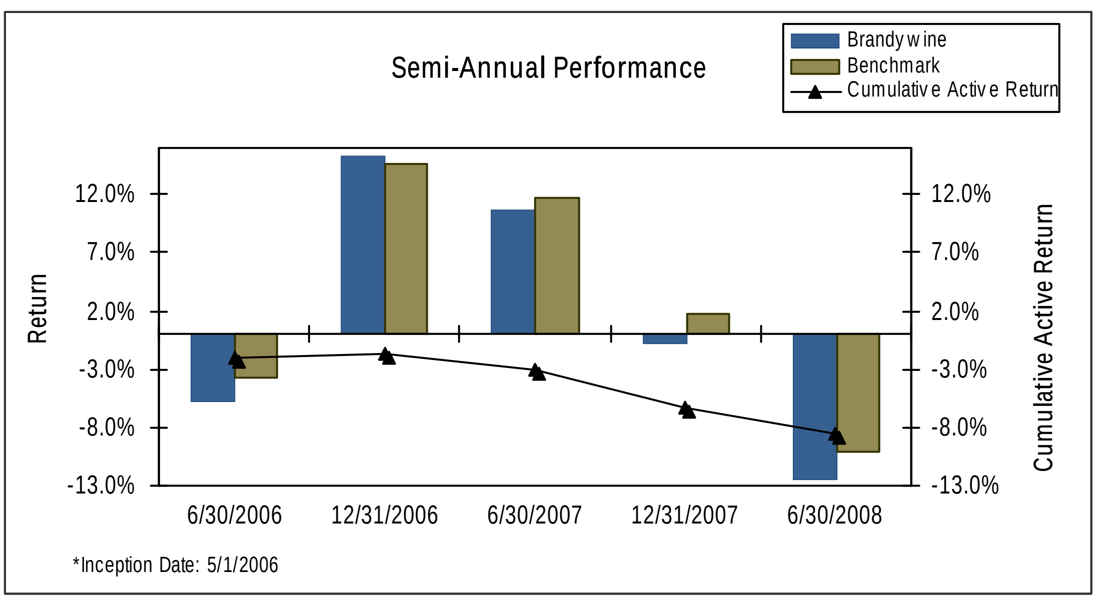
Brandywine was funded on May 1, 2006. This manager uses quantitative screening to select stocks that are trading below normal valuation. Fundamental research highlights firms that have the catalysts in place to spur a return to normal valuation. Brandywine excludes stocks with unfavorable ratings, supplied by Legg Mason Investment Counsel, based on: environmental awareness and footprint, stakeholder relations, location/industry specific issues, and evaluation of public perception. The portfolio typically holds 50-90 stocks.

For the fiscal year ending June 30, 2008, Brandywine underperformed the benchmark by 4.67%. While this manager has underperformed from inception, the past fiscal year was particularly difficult for value managers like Brandywine. Underperformance was due primarily to poor stock selection in the financials, materials, and information technology economic sectors, as well as an underweight in telecommunications. Assets under management as of June 30, 2008 were $78.2 million.

Manager	Fiscal Year 05/06	Fiscal Year 06/07	Fiscal Year 07/08	Annualized Since Inception*
Brandywine	**(5.83%)**	**27.62%**	**(13.14%)**	**2.00%**
Benchmark	**(3.73%)**	**28.06%**	**(8.47%)**	**5.73%**
Active Return	**(2.10%)**	**(0.44%)**	**(4.67%)**	**(3.73%)**

*Inception Date 5/1/06 Source: State Street Bank Returns are net of fees and CFA compliant.

The chart below shows Brandywine's performance versus its benchmark. The left axis measures the manager's semi-annual performance against its benchmark. The right axis measures cumulative performance relative to the benchmark.



State Street Global Advisors (International)

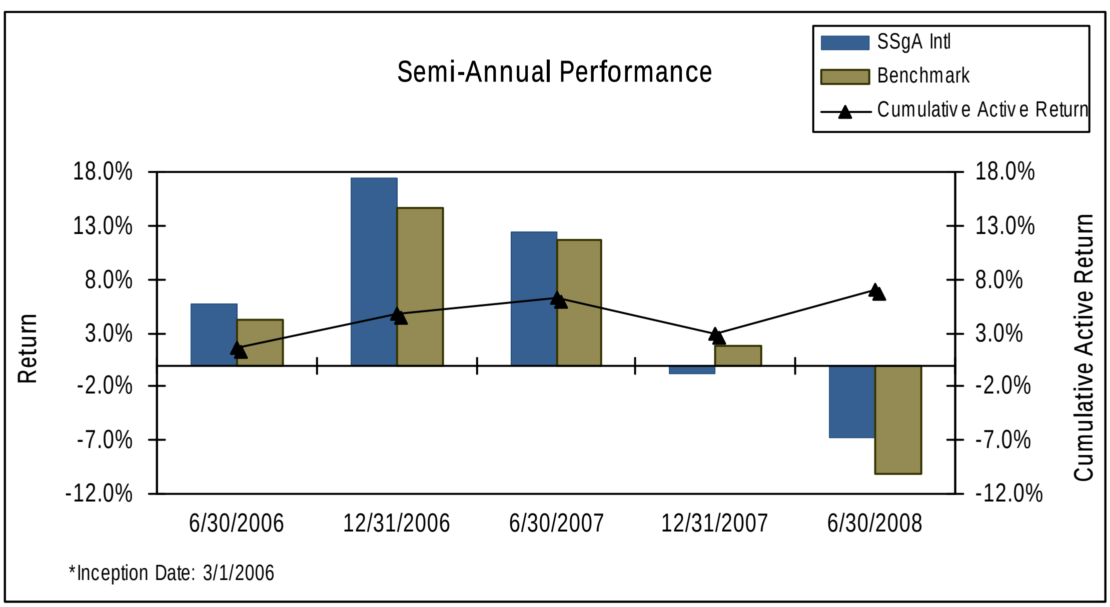
State Street Global Advisors (SSgA) was funded on March 1, 2006. SSgA's core non-U.S. equity stock selection approach is combined with environmental stock ratings supplied by Innovest. The process is a blend of quantitative analysis and qualitative assessments. Stocks are ranked according to factors that have been shown to identify mispricing: value, sentiment and earnings growth. Low-multiple stocks with improving earnings are favored and higher-multiple stocks with poor earnings prospects are avoided. The strategy is managed to have characteristics similar to the benchmark. The portfolio holds up to 150 stocks.

For the fiscal year ending June 30, 2008, SSgA outperformed the benchmark by 51 basis points. The portfolio benefited from good stock selection in the consumer discretionary, industrials, health care and consumer staples sectors. From inception, the SSgA international portfolio has outperformed its benchmark by 2.46%. Assets under management as of June 30, 2008 were $125.2 million.

Manager	Fiscal Year 05/06	Fiscal Year 06/07	Fiscal Year 07/08	Annualized Since Inception*
SSgA-Intl	**5.76%**	**32.09%**	**(7.57%)**	**11.58%**
Benchmark	**4.12%**	**28.06%**	**(8.47%)**	**8.91%**
Active Return	**1.64%**	**4.03%**	**0.90%**	**2.67%**

*Inception Date 3/1/06   Source: State Street Bank   Returns are net of fees and CFA compliant.

The chart below shows SSgA's performance versus its benchmark. The axis on the left measures the manager's semi-annual performance against its benchmark. The right axis measures SSgA's cumulative performance relative to the benchmark.



Next Steps

When CalPERS issued its Request for Proposal for Environmental Investing in May 2005, managers were asked to submit proposals for active U.S. equity management or active international equity management. The managers that were hired are, for the most part, managers that screen out firms based on environmental criteria.

As staff has continued to monitor the evolution of environmental investing, it seems clear that many managers choose to launch global equity products instead of U.S. only or non-U.S. only. In addition, staff believes there are now more opportunities to invest with managers who are targeting investments in companies that have an advantage in adapting to, or mitigating, climate change, rather than managers whose processes involve screening out companies. Therefore, staff believes that it would be worthwhile to conduct a new manager search some time in the coming fiscal year. Staff will prepare a separate agenda item on this topic for the Investment Committee's consideration at a future meeting.

In addition to external managers, staff is also looking at possible strategies that could be implemented internally. Whether staff recommends additional external or internal portfolios, it will likely be necessary to increase the Global Equity delegation to environmental strategies from the current 0% - 0.5% range. This issue will also be addressed in a future agenda item.

Recommendation

Staff recommends renewal of the contracts for all five environmental equity managers for a period of one year. Each contract contains a provision allowing for termination on 30 days' notice.

V. STRATEGIC PLANS:

External investment manager performance is monitored by staff and reported to the Investment Committee per CalPERS Strategic Plan, Goal VIII to manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.

VI. RESULTS/COSTS:

The purpose of this item is to keep the Investment Committee informed of the performance of the environmental external equity manager program.

Prepared By:

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WILSHIRE CONSULTING

Attachment 1

Michael C. Schlachter, CFA
Managing Director & Principal

August 5, 2008

Ms. Anne Stausboll
Interim Chief Investment Officer
California Public Employees' Retirement System
400 P Street, Suite 3492
Sacramento, CA 95814

Re: Environmental Equity Managers Contract Renewal Recommendation[1]

Dear Anne,

You requested Wilshire's opinion with respect to Staff's recommendation pertaining to the annual review and renewal of the contracts of the external domestic and international environmental equity managers. Wilshire concurs with Staff's recommendations, and our comments regarding all 5 equity portfolios are below.

In addition, Wilshire has had a number of discussions about Staff regarding the future of this program, and these discussions remain ongoing. One of the main issues we are struggling with is how to make this program live up to its original charge of reducing investment risk from climate change and potentially "doing good" while still "doing well." One concept that Wilshire and Staff have been discussing is to change the focus of the program from simply one of conventional investment products with an environmental screen applied to a program that is focused more on public entities in the renewable energy, recycling, battery production, or carbon sequestration industries. In this way, rather than simply divesting the worst polluters from a small section of the equity portfolio, CalPERS might be able to encourage the growth and development of industries and products that can result in positive change. We will keep the Investment Committee apprised of these discussions as they move forward.

Discussion

During the 2008 fiscal year, the CalPERS environmental external manager program outperformed its benchmark by more than 1%, but still declined with the greater equity market, returning a total of -9.58% for the year. Surprisingly, the managers in general were able to add value over the benchmark despite an underweight to extractive

[1] Wilshire's Code of Conduct requires us to disclose which of the above firms are clients of Wilshire's Analytics Services Division and as such pay Wilshire a fee for the licensing of analytical software used in investment management. Wilshire's consulting division has no business relationship with them. This disclosure has been delivered under separate cover and is included as an attachment to this agenda item.

industries, which have been some of the best performing industries this year due to the continued appreciation in the prices of raw materials and energy. This leads us to conclude that it is possible for an environmentally targeted portfolio to actually add value over the benchmark, despite the reduced selection set of stocks the managers are given.

However, this performance may also have been more of a result of manager skill than passive industry bias since three of the five portfolios underperformed the unconstrained equivalent portfolios for the year. In a year in which active managers generally fared poorly, the five portfolios selected for this program, on average, did very well.

We support the annual contract renewal recommendation as the current stable of managers are relatively new and the improving performance track record of the overall program is not sufficiently long enough to determine if the managers are skilled or unskilled, or if the managers were victims in the first two years of adverse market movements in the sectors which they underweight. Staff has the authority to terminate managers who do not perform as expected, and they have used that authority when necessary and appropriate. The renewal of these contracts does not in any way preclude Staff from exercising the authority to terminate any manager who ceases to perform as expected subsequent to contract renewal. In addition, as noted above, Staff is in discussions with Wilshire about the future of this program, and renewing these contracts allows all more time to determine how CalPERS' assets can best be used to mitigate the effects of climate change.

AXA Rosenberg

AXA Rosenberg has managed a US large cap core environmental equity portfolio for CalPERS since April 1, 2006. AXA employs a quantitative strategy where the true value of each of 19,000 stocks in every market in the world is recalculated every three minutes, and each portfolio is subsequently optimized relative to the client's benchmark based on the results of any changes. Unlike many quantitative managers who employ a multi-factor model which is based on independent assumptions of what makes a stock cheap or expensive, AXA's models price each security based on what the market is paying for such securities. For example, the consumer software portion of Microsoft is valued based on where the market is valuing all the other consumer software companies, and then is added to the business software's valuation based on the current market valuation for business software companies. To the extent that the computed total valuation differs from the current stock price, AXA's models indicate whether the stock should be bought or sold. An equally quantitative methodology is used to predict the future earnings of companies, and this forecast is combined with the valuation model to construct a portfolio of stocks with index-like characteristics but superior growth and cheaper valuation. Since inception, this portfolio has had an annualized outperformance of 1.24%, completely as a result of a 3.79% outperformance in fiscal year 2008.

New Amsterdam

New Amsterdam was hired on February 1, 2006 to manage a US large cap core environmental equity portfolio for CalPERS. This is an active and fundamental portfolio that tends to have concentrated, high-conviction positions in 40 to 45 stocks. Although the manager has had a slight growth bias in the portfolio, which hurt performance during a time of general large value outperformance in fiscal years 2006 and 2007, this bias did significantly improve performance during fiscal 2008 when growth outperformed value. Since inception, the manager has lost an annualized 0.25% versus the benchmark, but obviously made great progress in catching up to the benchmark over the past year.

Last year, this manager was under review by CalPERS Staff and was the subject of an on-site due diligence review by Wilshire Associates. Staff and Wilshire decided to allow the manager more time to improve performance, and were rewarded for that patience over the past year.

Brandywine

Brandywine was hired on May 1, 2006 to manage a core-oriented developed markets ex-US environmental portfolio for CalPERS. Brandywine uses a combination of quantitative initial screens and fundamental analysis to pick what is essentially a moderately value-biased portfolio, although it is benchmarked against a core index. This bias has substantially impacted performance in quarters where growth outperformed value, especially in the second calendar quarter of 2007 and most of fiscal 2008. The manager is heavily reliant on fundamental valuation analysis and although this management style should be successful over time, it has not been a successful strategy since the manager was hired. The non-US portfolio performed poorly in its first calendar quarter following funding, and had almost made up all of that value lost by the end of the first calendar quarter of 2007, but then steadily lost value relative to the index throughout fiscal years 2007 and 2008. The manager now trails the benchmark by 3.73% annualized since inception, and it the only truly disappointing manager in this group. We recommend extending this manager's contract to allow Staff and Wilshire time to determine if this manager should remain in the program.

State Street Global Advisors

State Street Global Advisors (SSGA) manages two environmental equity portfolios for CalPERS – US large cap core and non-US developed markets. Both portfolios are managed in a similar fashion, with quantitative models driving the stock selection process. Portfolio construction is controlled by a computer optimizer that selects the "best" stocks (based on valuation, expected growth, riskiness, etc.) with the goal of closely tracking the overall characteristics of the index. The US portfolio performed well in the year after funding, lost 0.73% in the second year, and just missed the benchmark in the most recent year, underperforming by 0.26%. Given that quantitative portfolios in general had a very difficult year in fiscal 2008 due to a number of factors related to the on-going hedge fund de-leveraging and credit crunch, we believe that this near-miss on performance is still acceptable. Since inception, this portfolio trails the benchmark by 0.34% on an annualized basis.

The non-US portfolio is managed in an identical manner to the US portfolio, but has had substantially better results, adding value in all three years and generating an annualized value-added of 2.67%.

Conclusion

Through the on-going activities of both CalPERS' consulting team and Wilshire's Manager Research Group, we closely monitor the performance and investment processes of all of CalPERS' managers. In addition, as noted above, we recommend that one of these portfolios receive special review by both Wilshire and Staff. At this time, Wilshire concurs with Staff's recommendation to renew the contracts for all of the environmental equity managers, as CalPERS has the right to terminate any on 30 days notice and is currently reviewing the future direction of this investment program.

Sincerely,

Michael C. Schlachter, CFA